

BOARD OF EQUALIZATION
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	FORMAL OPINION
BENJAMIN R. DU AND)	2007-SBE-001
CARMELA L. DU)	Case No. 339310
)	

Representing the Parties:

For Appellant: Charles P. Rettig
Edward M. Robbins, Jr.
Sharyn Fisk

For Respondent: Jozel L. Brunett, Tax Counsel

Counsel for the Board of Equalization: Louis Ambrose, Tax Counsel

This appeal is made pursuant to section 19324, subdivision (a), of the Revenue and Taxation Code¹ from the action of the Franchise Tax Board (FTB or respondent) in denying the claim for refund of appellants Benjamin R. Du and Carmela L. Du in the amount of \$288,938 for 1999.

The question presented is whether appellants, who elected to participate in the Voluntary Compliance Initiative (VCI) pursuant to section 19752, subdivision (a), are barred from filing a claim for refund of the interest paid on the tax paid under the VCI. As set forth below, we hold that subdivision (a)(4) of section 19752 bars the filing of a claim for refund of interest paid on the tax paid for any taxpayer who elects to participate in the VCI under that subdivision. Consequently, appellants' claim for refund is invalid, and for that reason this Board lacks jurisdiction to hear and decide the matter presented.

¹ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

1 Appellants filed their original 1999 return on October 15, 2000, reporting taxable income
2 of \$38,865,301 and self assessing a total tax liability of \$3,611,089. Appellants subsequently entered
3 into a closing agreement with the Internal Revenue Service (IRS) in which they agreed to additional tax
4 based on potentially abusive tax shelter transactions. The federal deficiency was assessed to appellants'
5 account on April 26, 2004.

6 The FTB invited appellants to participate in the VCI program by letters dated December
7 3, 2003, and January 5, 2004. On February 17, 2004, appellants filed an amended VCI return for 1999,
8 electing the first option for participating in the VCI.² The amended return conformed to the federal
9 adjustments, reported taxable income of \$55,964,760, and self-assessed additional tax of \$1,590,250.
10 With the amended return, appellants remitted most of the amount needed to satisfy the balance of tax
11 and interest, and by April 15, 2004 appellants remitted the remainder.

12 On July 6, 2005, appellants filed a second amended return for 1999, claiming a refund of
13 interest paid based on the appellants' position that section 19116 suspends the imposition of interest
14 from April 15, 2002 (18 months from the filing date of the original return), through February 17, 2004
15 (the filing date of the first amended return). The FTB denied the refund claim and this appeal followed.
16 The oral hearing of this appeal was held on February 28, 2007, and at the conclusion of the hearing this
17 Board voted on the issue stated above which is the subject of this opinion.

18 In 2003, the California Legislature enacted the "Voluntary Compliance Initiative," which
19 allowed taxpayers to file amended returns, disclose potentially abusive tax shelter transactions, pay the
20 resulting tax and interest, and avoid the application of penalties. (Rev. & Tax. Code, § 19751 et seq.)
21 Taxpayers were allowed to file amended VCI returns during the period from January 1, 2004, through
22 April 15, 2004, inclusive. (Rev. & Tax. Code, § 19751, subd. (b).)

23 Taxpayers could elect to participate in the VCI without a right to appeal, the first option,
24 or with a right to appeal, the second option. Appellants elected to participate under the first option,
25 which provides that:

- 26 • The state waives all penalties imposed for underreporting tax liabilities attributable to

27
28 ² The two VCI options will be discussed in more detail in this opinion.

1 abusive tax avoidance transactions (Rev. & Tax. Code, § 19752, subd. (a)(1));

- 2 • The taxpayer is immune from criminal prosecution in connection with the abusive
3 transactions for the taxable years for which the taxpayer voluntarily complies (*Id.*, subd.
4 (a)(2)); and,
5 • The taxpayer “may not file a claim for refund for the amounts paid in connection with” the
6 abusive tax avoidance transactions. (*Id.*, subd. (a)(4).)

7 Appellants contend that the interest paid and at issue in this appeal is not included in
8 “amounts paid” within the meaning of section 19752, subdivision (a)(4). Thus, appellants maintain that
9 by electing the first VCI option they did not waive their right to claim a refund of the interest, and
10 therefore this Board has jurisdiction to hear this appeal of the FTB’s denial of that claim. Appellants
11 further contend that, even if the interest at issue is included in “amounts paid” for purposes of section
12 19752, subdivision (a)(4), this Board still has jurisdiction to hear the appeal.

13 With respect to the construction of the term “amounts paid,” appellants contend that the
14 expression of legislative intent in the enactment of the VCI and the statutory provisions specifying the
15 application of the VCI indicate that the term “amounts paid” refers only to the underlying tax liability,
16 and not to the interest imposed on that liability. Appellants first note that the Legislative Counsel’s
17 Digest for SB 614 (which enacted the VCI program) explained that the FTB would be required to
18 develop and administer a program “to apply to tax liabilities attributable to the use of abusive tax
19 avoidance transactions” (Emphasis added by appellants.) Appellants also point to the language of
20 the following VCI statutory provisions which, they contend, indicate that “amounts paid” refers only to
21 tax, and not interest: section 19751, subdivision (b), generally provides that the VCI “shall apply to tax
22 liabilities attributable to the use of abusive tax avoidance transactions” (Emphasis added by
23 appellants); section 19752, subdivision (a)(1), the first VCI option, provides that the FTB shall waive or
24 abate all penalties imposed “as a result of the underreporting of tax liabilities attributable to the use of
25 abusive tax avoidance transactions.” (Emphasis added by appellants.); and, finally, under section 19754,
26 subdivision (a)(1), a taxpayer is required to file an amended return where the taxpayer has previously
27 used an abusive transaction “to underreport the taxpayer’s tax liability for that taxable year.” (Emphasis
28 added by appellants.)

Appellants assert that tax and interest are distinct concepts in numerous provisions of the Revenue and Taxation Code that define “tax” exclusive of interest. As one example, appellants cite section 23036, which defines “tax” as the tax imposed under various sections of the Bank and Corporation Tax Law. Additionally, appellants note that section 19101, subdivision (c)(1), treats interest differently from the underlying tax because it has an exception for the references to “tax” in the sections that govern the procedures for assessing tax deficiencies. Appellants also argue that courts have long-recognized that a claim for refund of interest is a discrete claim from the underlying tax. Appellants cite a footnote in *Flora v. United States* (1960) 362 U.S. 145 (*Flora*), in which, appellants state, the Supreme Court clearly noted the distinction between tax and interest. (*Flora v. United States*, *supra*, 362 U.S. at p. 171, fn. 37.) Appellants also cite *Chen v. Franchise Tax Board* (1998) 75 Cal.App.4th 1110 (*Chen*), as support for their position that payment of interest is not a jurisdictional prerequisite to judicial review of a tax refund action.

Finally, appellants assert that even if the interest is included in “amounts paid” within the meaning of the VCI, they still had the right to file a refund claim and, subsequently, file an appeal. In this respect, appellants contend that the VCI only required them to pay the correct amount of taxes and interest, not to overpay. Section 19754, subdivision (a)(2), requires full payment of the tax and interest “due.” The interest at issue here, they argue, was not “due” because it should have been suspended under section 19116. In fact, they argue, interest suspension is statutorily required by section 19116. Appellants assert that they paid the subject interest under duress, in that respondent would not allow them to participate in the VCI (and receive the benefits of the VCI) unless they paid all of the tax and interest as computed by respondent. For these reasons, appellants contend that they are entitled to claim a refund of the subject interest and it would be inequitable to deny them that right.³

Respondent contends that the interest paid on the underlying tax liability is included in “amounts paid in connection with abusive tax avoidance transactions” for purposes of section 19752, subdivision (a)(4). Respondent asserts that the phrase “in connection with” means “associated with, or

³ In this context, appellants argue that denial of their appeal rights would violate the Due Process and Equal Protection clauses of the United States Constitution. This Board, however, has a policy of abstaining from constitutional issues, and we are prohibited from determining that statutes (such as section 19752) are unconstitutional. (Cal. Const., art. III, § 3.5; *Appeal of Aimor Corporation*, 83-SBE-221, Oct. 26, 1983.) Thus, those arguments are not addressed in this opinion.

1 related” so that all of the tax and interest paid by April 15, 2004, was undisputedly paid in connection
2 with the self assessment on the VCI return. Thus, the FTB contends that under the first VCI option
3 appellants waived their right to file a claim for refund of the interest paid and, as a result, this Board
4 lacks jurisdiction to hear this appeal.

5 In addition, the FTB cites the “Voluntary Compliance Participation Agreement Form”
6 that appellants filed with their amended VCI return. On the agreement, appellants checked the box for
7 VCI option one, which included the statement:

8 “I elect to participate in the VCI under Option 1. I understand that I waive my right to
9 appeal or file a claim for refund for any amounts paid under this VCI.”

10 The FTB notes that appellants signed the agreement under penalty of perjury and thereby waived their
11 right to file an appeal. The FTB states that appellants could ask the FTB to review the accuracy of the
12 interest computation, which has been done, but that appellants have no further right of appeal.

13 Section 19754 states that the VCI applies to any taxpayer who, among other
14 requirements, filed an amended return that reports income from all sources without regard to abusive tax
15 avoidance transactions (Rev. & Tax. Code, § 19754, subd. (a)(1)) and paid in full “all taxes and interest
16 due.” (*Id.*, subd. (a)(2).) Section 19752 allowed “any taxpayer who meets the requirements of section
17 19754” to participate in the VCI by electing “either, but not both,” of two options. Section 19752,
18 subdivision (a), sets forth the first VCI option as follows:

19 “(a) Voluntary compliance without appeal. If this option is elected, then each of the
20 following shall apply:

21 “(1) The Franchise Tax Board shall waive or abate all penalties imposed by this part, for
22 all taxable years where the taxpayer elects to participate in the initiative, as a result of the
23 underreporting of tax liabilities attributable to the use of abusive tax avoidance
24 transactions.

25 “(2) Except as provided in Section 19753, no criminal action shall be brought against the
26 taxpayer for the taxable years with respect to issues for which the taxpayer voluntarily
27 complies under this chapter.

28 “(3) No penalty may be waived or abated under this chapter if the penalty imposed is
attributable to an assessment of taxes that became final prior to December 31, 2003.

“(4) Notwithstanding Chapter 6 (commencing with Section 19301) of this part, the
taxpayer may not file a claim for refund for the amounts paid in connection with abusive
tax avoidance transactions under this chapter.” (Emphasis added.)

Section 19752, subdivision (b), sets forth the second VCI option which is not at issue in this appeal.

1 The plain language of the first VCI option precludes the filing of a claim for refund of
2 “amounts paid in connection with” the abusive tax avoidance transactions disclosed on the VCI return.
3 Further, appellants signed an agreement in which they consented to waive their right to appeal or file a
4 claim for refund for any “amounts paid under this VCI.”

5 First, we observe that the Legislature chose the phrase “amounts paid” rather than “taxes
6 paid.” The Legislature is presumed to know what it is saying and to have meant what it said when it
7 enacts or amends legislation. (*County of Santa Clara v. Hall* (1977) 23 Cal.App.3d 1059, 1065; *People*
8 *v. Pina* (1977) 72 Cal.App.3d Supp. 35, 39.) Thus, we conclude initially that the Legislature did not
9 intend to limit the prohibition only to claims for refund of taxes.

10 Secondly, statutes are given effect according to the usual, ordinary import of the language
11 used in framing them, and where the statutory language is clear and unambiguous, there is no need for
12 construction. (*People v. Belleci* (1979) 24 Cal.3d 879, 884; *Solberg v. Superior Court* (1977) 19 Cal.3d
13 182, 198.) The primary definition of the word “amount” is the “total of two or more quantities; the
14 aggregate.” (*The American Heritage College Dictionary* (3d. ed.1993); *Funk & Wagnalls Standard*
15 *College Dictionary* (1973); *Dictionary.com Unabridged (v 1.1)*, Random House, Inc. (accessed: January
16 31, 2007).) In tax cases, federal courts have given a broad meaning to the phrase “in connection with,”
17 defining it as “associated” and “related.” (See *Snow v. Commissioner* (1974) 416 U.S. 500, 502-504;
18 *Huntsman v. Commissioner* (1990) 905 F.2d 1182, 1184; *Fort Howard Corp. v. Commissioner* (1994)
19 103 T.C. 345, 352.) Under the VCI, the additional tax is imposed for prior underreported tax liabilities
20 and the interest attaches to that tax because it has not been paid timely. (Rev. & Tax. Code, § 19101,
21 subd. (a).) Thus, the ordinary language meaning of the phrase “amounts paid in connection with an
22 abusive tax avoidance transaction” under the VCI would necessarily include both tax and interest.

23 We reject appellants’ statutory construction based on the references to “tax liabilities” in
24 the Legislative Counsel’s Digest and in the VCI statutory provisions. It is clear from the context in
25 which those references appear that they are necessary solely to explain the purpose and the application
26 of the VCI, which was to allow taxpayers to avoid penalties for prior underreporting of tax liabilities,
27 when such underreporting resulted from an abusive tax avoidance transaction. Contrary to appellants’
28 suggestion, the term “tax liabilities” does not place a limitation on the nature of the payment associated

1 with the abusive tax avoidance transactions that are the subject of the VCI. As stated above, the
2 statutory authority for imposing interest, section 19101, subdivision (a), provides that interest is
3 mandatory when any amount of tax “is not paid on or before the last date prescribed for payment”
4 Pursuant to that provision, interest must be imposed on the additional tax paid under the VCI because
5 that tax was not paid timely. Moreover, eligibility for participation in the VCI requires full payment of
6 the “taxes and interest due.” (Rev. & Tax. Code, § 19754, subd. (a)(2).) Thus, “amounts paid” under
7 the VCI must always include interest on the tax paid. Consequently, appellants’ citation of *Flora* and
8 *Chen* for the proposition that the courts have recognized the distinction between tax and interest is
9 irrelevant because, as we hold above, “amounts paid” under the VCI means tax and interest.

10 Even if we were to accept appellants’ interpretation that the term “amounts paid” under
11 the VCI is controlled by the term “tax liabilities,” section 19101, subdivision (c)(1), expressly provides
12 that any reference to any tax in the Personal Income Tax Law, the Bank and Corporation Tax Law, and
13 the Administration of Franchise and Income Tax Law, except sections 19031 through 19067, “shall be
14 deemed also to refer to interest imposed by this article on that tax.” Sections 19031 through 19067
15 govern the procedures for assessing tax deficiencies and the VCI is not contained within those sections.
16 Therefore, the references to “tax liabilities” under the VCI relied upon by appellants are deemed by
17 statute to include the interest imposed on the tax.

18 Appellants’ argument that section 19752, subdivision (a)(4), does not prohibit a claim for
19 refund of any amount in excess of the “correct” tax and interest “due” essentially renders that provision
20 meaningless. The first VCI option is intended as a trade-off whereby the state waives all penalties and
21 in return a participating taxpayer waives all appeal rights. To be consistent with that purpose, the FTB
22 must have the exclusive authority to determine the correct amount of tax and interest “due.” Otherwise,
23 according to appellants’ argument, any taxpayer who elected the first VCI option could assert that the
24 *tax* paid exceeded the amount that was “due,” file a refund claim and have the merits of that claim
25 adjudicated. Such a result would violate the canon of statutory construction that a court must avoid a
26 construction of a statute which would render some words meaningless or inoperative. (*People v. Cruz*
27 (1996) 13 Cal. 4th 764, 782.)
28

1 Based on the foregoing, we conclude that appellants do not have the right to file a claim
2 for refund of the interest paid on the tax paid in connection with abusive tax avoidance transactions.
3 Because appellants are barred by statute from filing a claim for refund of the interest amount at issue, it
4 follows that this Board does not have jurisdiction to hear an appeal from the Franchise Tax Board's
5 denial of such a claim. (See Rev. & Tax. Code, §§ 19322 – 19333.)
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ORDER

Pursuant to the views expressed in the opinion, and good cause appearing therefore,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that this appeal is dismissed for lack of jurisdiction because appellants' claim for refund of interest paid is invalid pursuant to Revenue and Taxation Code section 19752, subdivision (a)(4).

Done at Sacramento, California, this 17th day of July, 2007, by the State Board of Equalization, with Board Members Ms. Yee, Ms. Chu, Mr. Leonard, Ms. Steel and Ms. Mandel present.

Betty T. Yee, Chair

Judy Chu, Ph.D, Member

Bill Leonard, Member

Michelle Steel, Member

Marcy Jo Mandel*, Member

*For John Chiang per Government Code section 7.9.

Appeal of Benjamin R. Du and Carmela L. Du